



# Tax Treatment of Net Operating Losses (NOLs) in the Coronavirus Aid, Relief, and Economic Security (CARES) Act

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Increased benefits from net operating losses (NOLs) had been discussed as part of the response to the economic effects of the coronavirus (COVID-19). The [Coronavirus Aid, Relief, and Economic Security \(CARES\) Act](#) (P.L. 116-136) included a provision increasing tax benefits for NOLs. This revision temporarily suspends current rules that were last revised in the 2017 tax revision, popularly known as the Tax Cuts and Jobs Act (TCJA) (P.L. 115-97).

## Temporary Revisions in the CARES Act

Under current permanent law (enacted in the TCJA and effective in 2018), when a firm has a loss (a net operating loss, or NOL), taxes are not reduced immediately beyond zero. Rather, the business owes no income tax in that tax year and the loss can be carried forward indefinitely. In subsequent years, the NOL can be used to reduce up to 80% of taxable income, reducing taxes in the future. Individual taxpayers' losses that can be offset against nonbusiness income are limited to \$500,000 for joint returns (\$250,000 for single returns), under a provision that expires after 2025. Prior to the TCJA, losses could be carried back two years and carried forward 20 years, fully offsetting tax liability. Carrybacks of losses yield immediate tax reductions, while carryforwards reduce future tax liabilities. There were no dollar limits on loss offsets for individuals.

The CARES Act allows firms to carry back losses in tax years beginning after December 31, 2017, and before January 1, 2021 (for calendar year firms, covering 2018, 2019, and 2020) for up to five years. NOLs carried back can also offset 100% of taxable income—an increase from the 80% offset under permanent law. The Internal Revenue Service has issued [guidance](#).

In addition to allowing immediate tax benefits for losses incurred in those years and increasing the loss carryback to cover 100% of taxable income, carrybacks reduce taxable income previously taxed at higher rates under pre-TCJA rates. The TCJA reduced corporate rates from 35% to 21%, and reduced individual rates in many cases, including lowering the top individual rate from 39.6% to 37% or 35%. Thus, for corporations, a dollar of loss carried forward to the future would save \$0.21 in taxes, whereas a dollar of

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loss carried back to years before 2018 would save \$0.35 in taxes. Losses incurred in 2018 could be carried back as far as 2013.

The CARES Act also suspended for 2018-2020 the provision in the TCJA (Section 461(l)) that limited the amount of NOLs that individuals could use to offset other income. It also clarified that other income included wages from the business for purposes of the limitation in future years.

The CARES Act also included a [technical correction to the TCJA](#), allowing certain firms whose fiscal years are not based on calendar years to use the pre-TCJA rules for losses in the year spanning 2017 and 2018. It also allows taxpayers to disregard years in which a tax was paid under the TCJA's transition tax (Section 965) on previously accumulated earnings abroad.

The [Joint Committee on Taxation](#) estimates a revenue loss of \$80.0 billion in FY2020 and \$8.7 billion in FY2021 from the general NOL changes. This revenue loss is followed by gains in subsequent years, resulting in an estimated overall loss of \$59.5 billion in the first six fiscal years (FY2020-FY2025) and a loss of \$25.5 billion in the first 11 years (FY2020-FY2030). Some of the revenue loss is a matter of timing (receiving tax reductions now instead of in the future) and some is permanent due to the tax rate differential.

The lifting of the limit on losses for individuals was estimated to lose \$74.3 billion in FY2020 and \$64.0 billion in FY2021, with smaller amounts in subsequent years, for an overall estimated loss of \$135.2 billion in the first six years (FY2020-FY2025) and \$135.0 billion in the first 11 years (FY2020-FY2025). The [Joint Committee on Taxation](#) has estimated that 82% of the revenue loss is realized by taxpayers with expanded incomes of \$1,000,000 or more.

These provisions have been [criticized as benefiting wealthy taxpayers](#). Senator Sheldon Whitehouse (S. 3640) and Representative Lloyd Doggett (H.R. 6579), with numerous cosponsors, propose to restore the limits on individual loss offsets against ordinary income, provide NOL carrybacks for two years for 2020 losses, limit carrybacks to businesses with gross receipts up to \$15 million, and make other changes.

The Health and Economic Recovery Omnibus Emergency Solutions (HEROES) Act (H.R. 6800) would provide carrybacks for 2019 and 2020, but only back to 2018, and restore and impose permanently the \$500,000 (\$250,000) limits on business losses that can be offset against ordinary income. [The revenue gains](#) over a 10-year period are \$254.1 billion, with most of that gain (\$246.2 billion) due to the limit on individual losses.

More generous NOL treatment has been used in the past [to address the effects of disasters and economic downturns on businesses](#).

## Economic Effects

A broad swath of industry, [including energy, manufacturing of durable equipment, travel, and tourism](#), as well as the [restaurant industry](#) is expected to be especially affected by economic slowdown from the COVID-19 pandemic. An objective of more generous NOL rules is to increase liquidity and cash flow and make it easier for businesses that benefit to survive the economic disruption caused by the pandemic. A [survey of manufacturers](#) indicated that 3.9% of firms had taken advantage of the more generous rules.

Past expansions of NOLs have been used as economic stimulus. More generous NOLs are not expected to be a particularly effective stimulus to the economy, as stimulating the economy generally requires some incentive to spend. The efficacy of a provision as a fiscal stimulus is reflected in its projected multiplier effects (how much output a dollar's worth of revenue or spending causes) and [both the Congressional Budget Office and Moody's \(a private forecaster\) estimated small effects](#) for NOLs. (Note, however, that these estimates were made during the Great Recession and the underlying causes were different.) Increased cash flow is not generally viewed as an incentive to invest, and thus usually has limited

effectiveness as economic stimulus. As noted above, however, it can provide increased liquidity and cash flow.

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